determine the support. Today, the major LEC's under 10 companies are representing approximately 90 percent of the lines.

If I look at the small rural telephone companies which represent over 1,300 companies in this country, they represent approximately 5 percent of the lines. Of those five percent of the lines that their truly rural companies represent, 55 percent of those lines are in areas that have a 100 lines per square mile or less. That is a phenomenal statistic such that clearly there needs to be a solution to the small rural companies that represent 1,300 companies in this country.

However, the notion of giving distributions to the major LEC's from an explicit fund, one that ultimately is supported by revenues from their competitors is untenable. These local companies are giant corporations earning record profits. They certainly have the wherewithal to deal with the high cost needs.

As AT&T has demonstrated in its May 15 comments, in the vast majority of cases, the major LEC's current local revenues compensate them fully for all of their universal service costs. For 62 of the major non-rural LEC's, 71 study areas end user local service revenues, including the interstate subscriber line charge fee, exceed the forward looking costs of service. And indeed, exceed it by well discontinued.

AT&T does not oppose payment of high cost support for non-major local companies. However, the Commission should not adopt a methodology that would increase needlessly the size of the fund. Yet, the Commission's proposed methodology, if it determines the high cost funding requirements at the wire center level or below, would do just that.

To insure that ratepayers are not burdened with funding support payments beyond what is needed to insure universal service, the Commission should, instead, calculate the support at the study area level. As the Commission, itself, recognized in the universal service order, universal support should not be calculated at a greater level of geographic disaggregation than unbundled network elements. Most states have not disaggragated unbundled network rate elements for the loop below the study area level. And those that have, have disaggragated them into only three or four rate zones. There's probably over 20 or 25 states that have only one unbundled loop rate.

In addition, even this slight disaggregation remains more of a theoretical curiosity rather than providing real competitive opportunity because of excessive glue charges and non-functional operating support system, and neither anti-competitive conditions even in the few

I want to start out with a few general observations to put Sprint's proposal into some context. To begin with, I think we need to start with the reality of today. And the reality of today is that the universal service funding that exists, both implicitly, and more implicitly, as well as explicitly, is indeed huge. The Telecom Act requires that these implicit subsidies be made explicit and recovered in a competitively neutral manner. Indeed, Sprint believes that the development of an explicit, competitively neutral universal service fund is a prerequisite to vibrant facility-based local competition.

We also need to recognize that the only way to reduce the size of the universal service funding that exists today is to rate rebalancing. And we are certainly in agreement with others on this panel that have pointed out that the level of local rates today is way below the affordable levels. And that we need to have rate rebalancing considered as a part of the solution to the universal service problem.

Finally, we do not need to create new revenues to address universal service funding. The revenues exist today, and simply need to be more efficiently targeted to accomplish the goals of the universal service.

Given that background, Sprint's proposal is, first, that the universal service funding be based on states that have disaggragated union rates, there has been no ability for new entrants to compete. Therefore, the Commission should continue to calculate support at the study area level in all states as it does under the current system.

Finally, because of the underlying predicate for establishment of universal service system, local competition has thus far been stymied. It is not necessary to implement the new high cost support system January 1991.

Section 254(a)(2) of the Act expressly authorizes the Commission to establish a timetable for implementation of the new universal service system. That is consistent with the standards and purposes of the Act. But there has been no entry into the local exchange access market sufficient to put competitive pressure on those existing sources of universal service.

Therefore, the Commission can and should lawfully postpone implementation of the redesigned system until such competition arrives.

Thank you very much.

CHAIRMAN KENNARD: Thank you, Mr. Lubin. Mr. Sichter?

MR. SICHTER: Yes, thank you. I'm Jim Sichter, Vice President of Regulatory Policy for the Sprint local telecom division.

forward looking economic costs, that we have a national that universal service funding be assessed on state and interstate revenues, that all services, all providers, all customers pay on an equitable basis. Thirdly, that the benchmark for determining universal service should be set at the maximum affordable rate levels. Again, we need to target subsidies to those who truly need it to keep them on the network and not to maintain low subsidized local rates that are not necessarily to accomplish universal service goals.

Support must be made portable and equitably available to CLEC's as well as ILEC's. The plan must be revenued neutral at its inception. Again, any universal service funding that an ILE gets above and beyond today's levels, must be offset dollar for dollar with reductions in implicit subsidies.

And finally, universal service funding must be recovered through a uniform surcharge on end user bills.

Thank you.

CHAIRMAN KENNARD: Thank you very much. We'll now take a short break. Let's reconvene here at 20 minutes to 12. And we'll then go to some questioning of the panelists. Thank you.

(Whereupon, a short recess was taken.)

CHAIRMAN KENNARD: Okay. I'd like to bring us back to order, please, so that we can stay within striking distance of being on schedule today.

We're now going to go into the Q and A phase of our panel this morning. And I'd like to do this somewhat freeform, sort of like an oral argument where Commissioners here -- and you will get some rebuttal time, I assure you. So, that Commissioners can jump with questions as the spirit moves them.

And I think in these discussions, it's always useful if we can get a little bit of debate going among the panelists. Obviously, you all have differing points of view. You've all done a lot of thinking about your issues. And I think it would be most helpful to us if we could get a little point/counterpoint going. And I'd like to start that off by asking a couple of questions of Mr. Lubin and Mr. Brown.

Mr. Lubin, you have advocated for some time now that the FCC should reduce the rate of interstate access charges. And often times, your proposals are met with opposition from the local exchange carriers represented here by Mr. Brown, who have argued that if we are to reduce interstate access charges, than we would somehow threaten universal service.

So, I would like to ask each of you to comment on that. And I'd like, particularly to know, how much of the universal service subsidy is today embedded in access charges? And what is the break off point? And if we were to start a process of reducing access charges, how would we reconcile that with the obligation to provide universal service?

Mr. Lubin, would you like to start off?

MR. LUBIN: Sure. Thank you for the question. Very complicated question, and it finally comes down to what you believe is the cost standard, in my view, for universal service. That's one critical question.

The other critical question is, who are we addressing? Are we addressing the major local companies who represent about 90 percent of the lines, or the truly rural companies who represent five to seven percent of the lines?

And so, my remarks are going to address the 90 percent issue in terms of the major local exchange companies because I truly believe the small rural areas, as I said in my comments, that roughly 55 percent of their lines are in densities that have a hundred lines per square mile. That is a very, very high cost area and creates a unique problem.

But for the 90 percent of the lines, the question is, what cross-standard do you use? The Commission came out and said forward looking. And now, there's a critical question is selection of a cost proxy tool and the inputs in the level of disaggregation. And if you select a study area level of disaggregation for the large carriers, what you'll find, at least with the inputs that we've looked at, would say that the local revenues including the interstate subscriber line charges at a study area level for the large major local companies, the revenues are well in excess of forward looking costs.

Therefore, from my point of view the interstate access fees -- again, if you pick the model, you pick the inputs and you pick a study area level of aggregation consistent with how roughly 20 to 25 percent of the states don't have disaggregation of the unbundled loop, meaning it is already at a study area level, what I, therefore, conclude, with this interstate aside, because I've included in that analysis. But the carrier to carrier access for the major LEC's is not implicit subsidy.

So, from our point of view, given the logic I just laid out, I would say to you, you can -- if you define universal service at the level of disaggregation that I just described, I would say to you that carrier to carrier access fees at the major LEC level, does not include implicit subsidies for local service.

And therefore, from my point of view, if you did the kind of things I just said, you can set up a rulemaking tomorrow to aggressively take access costs down with the logic that I just laid out.

CHAIRMAN KENNARD: Thank you, Mr. Lubin. Mr. Brown?

MR. BROWN: Well, it might not surprise you that I'm going to disagree with Joel.

CHAIRMAN KENNARD: That's why I asked both of you.

MR. BROWN: I think it's a fairly simple problem. For generations, decades at least, we have been subsidizing local service with long distance services. At divestiture, that subsidy got rolled into access charges. At the access reform decision a year ago, the Commission set a target to reduce access to forward looking costs and estimated that was a reduction of $18.5 billion dollars.

Now, if you run the map, that $18.5 billion dollars is roughly $10 per residential line per month of support. Let me come at it from a different angle. If you take the same study I used to build the chart you have in the package using the staff common inputs, the average cost per residential line is $26 per month. And I don't know what the average residential rate is, but you know, 15 to 18 seems ballpark to me. So, there's -- you know, we've got that $10 per month that, you know, over time, through the separations process, very deliberately at Ozark and Chattanooga and all the other places where the separations evolved, it was put in there.

Now, what we've got to do is move it out. And as

I mentioned, you know, Commissioner Wood has suggested a phased approach. I think at some point, you know, we have to do one of two things. Either remove it and replace it with explicit support, or you know, maybe it's okay for access charges to have a higher margin.

For example, in talking to the people that are running the Media One competitive venture in Atlanta, they tell me that one of the single most important drivers in building a facility-based network, is to be able to bypass Bell-South's access charges. So, don't take them down because that's going to take away our incentives.

So, we don't have to pull it out. But as I mentioned in my comments, I think we have to take a reasoned approach to managing it as we go forward.

CHAIRMAN KENNARD: Well, certainly, you mentioned that access charges are subsidizing local rates. Certainly, some of that subsidy is coming from intrastate subsidies, business to residential and vertical services, intrastate toll. How do we get a handle on the percentage of subsidy from interstate access versus the intrastate portion of the subsidy?

MR. BROWN: Okay. On the loop plan, that's allocate 75 percent to the state, 25 to the Federal jurisdiction. So, I think, you know there was some intuitive logic in the 25/75 split. The problem comes for some states -- and I should mention that some states can solve that 75 percent problem very well themselves. But in other states, I think panelists said where you've got large numbers of high cost customers and no major urban area that gives you lots of low cost customers to spread it over.

Take, for example, North Dakota. We've got 21 cents a minute intrastate toll rate. We've got 7.6 cents per minute access rate on each end. We've got business rates at three times residents rates. That's where the support is coming from. That's where the vulnerability is because a lot of those are bought by business customers.

So, if you were to pile that on the North Dakota customer, that's where you get the spike like I was showing. South Dakota is in a similar situation. They've got similar demographics. And the states that don't have this large mass of low cost customers to spread the cost over, that we need some more help from the Federal jurisdiction.

CHAIRMAN KENNARD: Okay. Mr. Weller, did you want to get in here?

MR. WELLER: Mr. Chairman, if I could just add something. I think I mentioned earlier that like most economic problems, this one has constraints. The numbers in this chart have to add up and make sense relative to one another.

The only way out of that fix is to assume a different cost level. And that's basically what Mr. Lubin's done. For example, we've done a study of our serving area in Texas. If we were to take UNE rates at the levels predicted by the HAI model that Mr. Lubin was using to make his statements about profitability of local service, and if GTE were to sell its entire current output at those UNE rates, our revenue would fall by about 57 percent compared to where it is now.

So, that means -- Mr. Lubin's statement may be correct if you're willing to assume that the overall level of costs in the industry will somehow magically fall by half or two-thirds as a result of the FCC adopting an order. I'm not sure that that's a reasonable assumption.

Let me also note that if we do a study on individual customer segments by the amount that they purchased from us, and if we now assume, say, a CLEC coming into that same serving area in Texas, and buying UNE's at the interim rates that have been approved by the Texas Commission, 78 percent of the residents customers that we serve today would not cover their costs, even if we include all the revenues from all the services that those customers buy, and if we use those UNE cost rates which are substantially below our current costs as the CLEC's cost level.

CHAIRMAN KENNARD: I'd like to give Mr. Lubin an opportunity to respond, and than we'll move to one of my other colleagues here. Mr. Lubin?

MR. LUBIN: Thank you, Chairman. Dennis is absolutely right in terms of a key component of what I said. And that is, in Glenn's statement, he used a number of $26 for the cost of local service. Dennis refers to you need some kind of something to check to. And I presume that's kind of embedded costs.

And what I have said is not predicated on embedded costs. Absolutely, unequivocally correct. It is based on an estimate of forward looking costs of local service. And when you do that, lo and behold, you don't get this huge, huge dilemma for the major LEC's.

And that's why, in my humble opinion, what the condition did May of 1997 when it had an access reform order that talked about a market-based strategy, it basically had a potential solution to the dilemma that said, "Make local exchange competition work. Create the unbundled network elements. Go through and do everything and make the operating systems support a reality."

You create universal service using forward looking. And you don't have to have a zero sum, as Dennis would talk about, which would create a huge, huge fund. But you create the soft-landing approach that says, "Hey. Allow competition to enter, and then if there is a drain, it will occur, theoretically, slowly."

And by the way, they'll be in other businesses because they would have presumably met the checklist. The problem and the dilemma is, it isn't working. That doesn't mean you should walk away and use embedded costs. I would urge you still to continue to use forward looking.

But now, you come into the square dilemma that I posed. And that is if you do use forward looking, which is what I urge you to do to create a USF, what do you do in terms of access, because my assertion is you can take access down immediately. And then the issue is, okay, are you going to take $6 billion? That's Dennis's number earlier, or $10 billion out of the system immediately.

And I think we need to debate that, because when people say to me, "Hey. Competition and the business is there," and we're draining their profits and their revenues, I don't see it. I see interstate rates of return that each year have been going up in a significant amount. Even last year when there was a July 1997 $1.5 billion taken out because of the higher productivity factor reinitialized to '96, $1.5 billion taken out of the system.

What I see in April of 1998 showing that 1997 rate of return is a rate of return that was approximately, six, seven, eight percent higher than it was last year. And for some companies, it was probably 10 to 15 percent higher hitting 20 and 22 percent.

And so, from my point of view, which is the point earlier that says, "You know, can take some steps." And I think the step is decide the tool, decide the inputs, decide the level of aggregation, make that decision, but you don't have to implement it immediately because this competition isn't working the way in which it was envisioned. Thank you.

CHAIRMAN KENNARD: Thank you, Mr. Lubin. I want to go back to one of my opening themes which was follow the money, because, obviously, somebody has to pay for these subsidies. And that somebody is the American consumer. So, we have an obligation to make sure that that subsidy is used in the most efficient way possible.

I've proffered some principles on universal service, which really, fundamentally, are about that. Making sure that the subsidy is used in the most efficient manner. That we're not overfunding universal service.

Now, Mr. Lubin has proffered a way of doing that, a forward looking cost methodology. I'd like to know if any of the other of view have an alternative way of funding universal service that is not using a forward looking cost methodology, that still satisfies the principle of insuring that these subsidies are used in the most efficient manner possible.

Mr. Bush?

MR. BUSH: Let me -- Mr. Chairman, let me try. First off, our particular proposal from the state perspective, involves the use of a forward looking model. We propose the utilization of a forward looking model compared to the actual price that the consumer pays for the universal service service set, as sizing the total universal service fund. And it's a large fund. And indeed, as Dennis has indicated before, we have a large fund today. I mean, it's embedded in our implicit rates.

The issue for the -- that we believe for the Commission to deal with is how to size the interstate component, the amount of support that the interstate jurisdiction will provide. Our argument there is to take as a starting point the combined CCL, pixie and the existing explicit support that is currently in the system, translate that into a support mechanism that than flows to the states. The states can than flow that to the truly high cost wire centers, providing a specific portable interstate component to offset the state burden.

CHAIRMAN KENNARD: Mr. Shiffman?

MR. SHIFFMAN: Thank you. The lynch pin of the ad hoc approach is its ability to net high and low cost areas within any given state or study area. And to that extent, it does not Federalize or require additional Federal funding

MR. SHIFFMAN: Let me just actually follow the money. And I guess I can look at the U.S. West plan versus the ad hoc plan.

The ad hoc plan benefits those states with uniformly above average costs, but which are not -- don't have costs that are heavily skewed. And by heavily skewed, I mean there are states like California which have some very high cost areas in the Sierras, but moderately very low cost in the urban areas. There are states like Colorado who have very high costs in the Rocky Mountains and in eastern Colorado, but relatively low cost in Denver.

Those states would make out very well under the U.S. West approach of a high benchmark, because they have some very high cost areas. They're above the benchmark.

There are other states in the Appalachians and primarily in the Appalachians and other areas of the northeast, some in the midwest, who do not have very high skewed costs, but they have relatively high costs everywhere, but not in the astronomical level. Maybe they have costs in the $49 levels, but they don't have any costs that are very low in the $10 level. And they don't have any costs in the $100 level.

Those states will not get sufficient support under the U.S. West approach unless the benchmark is sufficiently low as to have a very high fund. So, if you look at who is for those areas where the state has the ability throughout their internal rate structure to provide service at affordable comparable rates to high cost areas.

And in some ways, our approach is similar to the Bell-South approach. That they made the comment that most of the universal service support in the country is not explicit, but it's implicit within the internal rate structures of any given company.

What we're proposing to do is keep that support within the intrastate rate structures of any given company. And on the state level, have states make that support which is now implicit, explicit but competitively neutral, but only to provide the Federal support where the state, when it balances its own high and low cost areas, comes wanting and needs funds from outside the state jurisdiction to meet the comparability test meant by the Act.

CHAIRMAN KENNARD: Let me just follow up briefly on that comment. I'm familiar with your proposal, and I think it has a lot to commend it. But I'm also familiar with your efforts to try to get more state support for it. And I understand that it has not been embraced by a number of states. Can you give us a sense of sort of what the dynamic is, how that breaks out? Why some states are supportive and others are not? And again, follow the money. Who pays? Who's advantaged, and who's disadvantaged?

supportive of the various plans, those states which have -- which are high cost -- relatively high cost, but are relatively high cost all over the place, but who have very few low cost areas, have been supportive of the ad hoc approach.

Those states which understandably will not get anything, which will have to create most of their explicit subsidies to replace their implicit subsidy in the state plan, don't find the ad hoc approach very attractive because it will not provide a lot of Federal dollars.

You're absolutely right. You follow the money and you see who is benefitted by the ad hoc approach, who is not benefitted by the U.S. West-type approach. And that's who we've got.

The other important thing is that we surprised a lot of people but we have the one low cost state or relatively low cost state in New York supporting the high cost approach. And part of the reason why, I believe, they've signed on with us, is that they believe the fund should be relatively small, there not should be significant dollars exported.

But I think they also realize that of the plans that provide for a small fund, that the ad hoc plan is the only one that provides sufficient dollars to those high cost areas like Maine and Vermont and West Virginia. And that the U.S. West approach attempts to make a plan, which is relatively small, by raising the benchmark. But in the process of doing that, they don't provide sufficient funds to the outlying states. And for that reason, I think they recognize that the U.S. West approach to provide enough money for Maine or Vermont or West Virginia, would result in a plan which would be too -- which would have too high a price tag.

So, I guess it's the combination of meeting both criteria, sufficiency and efficiency. And I think they recognize looking at our -- at the various approaches that are out there that only the ad hoc approach both balances both a sufficient plan in a deficient size.

CHAIRMAN KENNARD: Thank you. I'd like to hear from some of my other colleagues. Commissioner Ness?

COMMISSIONER NESS: Thank you, Mr. Chairman. How many of you -- this is going to be a quiz. Okay?

How many of you believe that one of the significantly distinguishing characteristics of your plan is to put downward pressure on cost, given that it is a declining cost industry, which we're all engaged? Can I see a show of hands? Okay. All right.

How many of you believe, similarly, that your plan would significantly spur efficient, not efficient investment? Okay. You guys really believe in your plans.

Okay.

How many of you believe that your plan is competitively neutral and the funding comes from competitively neutral sources? Well, this is getting interesting. Okay. Let's put it this way. Is there anybody who disagrees with any of those top things? Now, be honest about it.

CHAIRMAN KENNARD: Let's put them under oath.

COMMISSIONER NESS: All right. There we go. I'll throw a wild card in here. How many of you have factored in wireless solutions into your equations? A couple of -- questionable answers there. Okay.

How many of you believe, fundamentally, that the high cost fund should fund the lines to Ted Turner's ranch? And Time-Warner, you don't have to answer that question. Okay. There was no one who believes that the high cost -- yes. Okay. GTE, Mark Cooper believes that it should be. Bell South, the ad hoc committee, that we should be -- Jim Sichter from Sprint. Okay. That we should be funding the lines to Ted Turner's ranch. Okay.

MR. SICHTER: Depends on how much.

COMMISSIONER NESS: Okay. How many of you believe that the funding should be based on both interstate as well as intrastate, or intrastate as well as interstate revenues?

MR. BROWN: Together or separately?

COMMISSIONER NESS: That we should be tapping from the Federal fund -- that we should be tapping both the intrastate as well as the interstate revenues. Show of hands. Okay. GTE believes that's the case. Bell-South believes that's the case.

MR. WENDLING: Colorado Commission goes on the record. We have a footnote to that.

COMMISSIONER NESS: Okay.

MR. SHIFFMAN: The plan -- our plan doesn't do that, as Maine and Vermont have so said. As individual states, we believe it.

COMMISSIONER NESS: Okay. Did I see any other hands? Sprint believes that it should be for both. And I believe your testimony reflects that. AT&T?

MR. SICHTER: Inter only. But it's a function of how big the account is.

COMMISSIONER NESS: Okay.

MR. SICHTER: If the fund gets huge, than it's a different answer.

COMMISSIONER NESS: Okay. How many believe that we should look at the revenue generated by the lines, not just the cost of the lines in determining how much should be funded? Okay. We have CFA. We have Time-Warner. We have AT&T. Anyone else? We have Colorado Commission.

MR. WENDLING: Just Colorado.

COMMISSIONER NESS: Okay. And the others believe that it should only be based on costs so that if you can generate a tremendous amount of money from vertical services from the lines, from other data services or other services, that that should not count towards the determination as to whether or not the lines should be supported. GTE, you have an answer on that.

MR. WELLER: The problem is that it's not all the same revenue from the same lines. If everybody bought the -- exactly the same mix of services, I think you might get away with doing that. You'd send bad price signals, but the system would be sustainable. But the distribution is very highly skewed. You have high and low income people, both all buying toll and access services. Nationwide, I think 45 percent of the bill of people whose incomes are below $10,000 is toll.

COMMISSIONER NESS: Okay.

MR. WELLER: But it's still true that the majority of customers, the 78 percent that I mentioned don't buy enough of that stuff to get up to some average benchmark that you had said. So, if you do it that way, you wall off 78 percent of the customers from competition.

MR. COOPER: Commissioner, could I respond on the other side?

COMMISSIONER NESS: Okay. Let me get U.S. West first, than if you would respond. Go ahead.

MR. BROWN: In our plan, we focused more on the affordability and for the high cost area we set it high enough so that revenue benchmark almost becomes irrelevant, because the first cut in the Commission's May order had it about $31. And if we're -- you know, if we -- if affordability is above that, than it becomes a moot point.

COMMISSIONER NESS: Okay.

MR. COOPER: It's quite clear that for several decades now, we have been using all of these revenues to create just and reasonable rates at the state level. So, when every state commission decides rates that look at vertical services, they say, "We count that in. And those rates are just and reasonable. We've included call waiting and other kinds of revenues." So, it's clear that the notion that they can't be relied upon is simply not a legal fact. They can be relied upon.

Second of all, I'll be perfectly willing to identify the lines that don't generate enough when you include all the other revenue and fund them through universal service. That was the logic of 3151. And that's fine. We don't quibble with that.

The difficulty is the chart he keeps showing you where he's got the big shortfall, he's included 100 percent of the loop costs in that chart, which is contrary to your assumption, and I believe the correct policy.

COMMISSIONER NESS: Okay. Yes, Mr. Shiffman.

MR. SHIFFMAN: There's some confusion about the counting of revenues from vertical services or not. And that is one of the reasons why the ad hoc approach does not appear -- does not use a revenue benchmark at all, but uses an average state cost benchmark -- an average national cost benchmark. By using average costs, you're implicitly recovering all revenues that are recoverable from those services that provide those facilities.

So that, for example, if you're looking at Maine versus the national average of Vermont versus the national average, you're not excluding vertical service revenues. You're essentially assuming that the mix of vertical services coming in from each state that is the same as from another state. And you're not assuming a way or including explicitly those revenues, but you're not excluding them either.

COMMISSIONER NESS: Okay. Last comment on that?

MR. BROWN: I'd just like to add one thought. And that is, if you do include them in a benchmark, than you have to make certain that the cost model that you use includes the cost for those. Now, in HAI model and the BCPM, we have tried to get kind of a bare bones, so if we put more of the vertical in, that's another consideration